

Chief Financial Officer's Analysis of EPA's Fiscal Year 2004 and 2003 Financial Statements



Summary of Auditor's Report and Opinions

The Environmental Protection Agency (EPA) prepared the following Fiscal Year (FY) 2004 Financial Statements: Statement of Financial Position (Balance Sheet), Statement of Changes in Net Position, Statement of Net Cost, Statement of Budgetary Resources, Statement of Financing, and Statement of Custodial Activity. In addition, we

prepared a Statement of Net Cost by Goal for each of the Agency's 5 Strategic Goals.

The Office of Inspector General (OIG) Audit Report issued an unqualified audit opinion on the EPA's Fiscal Years 2004 and 2003 Financial Statements.

I. Reportable Conditions

During the audit, the OIG observed and noted 10 reportable conditions, none of which are considered material¹. The reportable conditions are summarized below, along with a short statement of the Agency's position with respect to each of those items.

EPA's Financial Management Quality Assurance Process. The OIG recommended improvements to EPA's Quality Assurance program. OCFO oversees the efforts performed in the Agency's finance community and believes the existing Quality Assurance program is effective. While there is always room for improvement, OCFO is in the process of updating the Quality Assurance Guide,

incorporating new principles and standards. In addition, OCFO will develop an action plan to monitor the program and provide annual training.

Unearned Revenue and Superfund Unbilled Oversight Cost Accruals. During the course of the audit, OIG noted some discrepancies in the unearned revenue and unbilled oversight cost accounts. However, they acknowledged the many improvements EPA made in accounting for Superfund State Contracts (SSCs) unearned revenue and unbilled oversight account transactions. During Fiscal Year 2004, OCFO automated several processes and made procedural improvements that resulted in more accurate

¹ A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level, the risk that misstatement of amounts would be material in relation to the financial statements being audited and would not be detected within a timely period by employees in the normal course of performing their assigned functions.

information. The OCFO's frequent communications within the finance community significantly reduced the level of effort required for year-end adjustments and confirmed that adequate internal controls exist. In addition, OCFO consolidated certain aspects of the unearned revenue accrual process. CFO will continue making progress in these two areas and explore additional improvement opportunities in concert with pending realignment of Agency financial duties.

Supporting Documentation for Accounts Receivable. The OIG noted instances where documentation for accounts receivables was not received timely, precluding transactions from being recorded in the financial management system consistent with Agency policy. OCFO believes the current policies and procedures adequately address accounts receivable reconciliation issues. OCFO, along with the finance community, reviewed more than 2,500 administrative actions totaling \$245.6 million and determined that less than 0.010 percent of the documents amounting to \$452,691.00, or 0.002 percent, were fell in this category. Although the amounts are immaterial for financial reporting, OCFO will collaborate with applicable agency offices and programs, ensure existing policies are followed and increase awareness on the importance of recording accounts receivable timely.

Recording Marketable Securities. The OIG found that OCFO did not promptly record marketable securities received from companies in settlement of debts. In Fiscal Year 2004, OCFO issued the marketable securities policy that documented roles and responsibilities and emphasized the need to strengthen processes associated with recording marketable securities. Historically, EPA receives very few securities each year in settlement of debts. In FY 2005, OCFO will evaluate policy implementation and identify and resolve needed improvements. In addition, existing marketable securities policy and procedures

will be updated to require quarterly Superfund Accounts Receivables analyses.

Accounting for Contractor-Held Property.

The OIG noted an accounting difference that understated the acquisition value and accumulated depreciation for contractor-held property. OCFO and the Office of Administration and Resources Management modified the methodology for estimating net book value, depreciation expense, acquisition value, and accumulated depreciation for all contractor-held property. This methodology was applied and resulted in accurate reporting in FY 2004 and continuing into the future.

Accounting for Obligations. The OIG observed few instances of obligations recorded in improper accounting periods. As noted by the OIG, the transactions in question, about one million, are immaterial in and of themselves to the financial statements with the billions in outstanding obligations. As a result, OCFO did not record the recommended adjustment for recording obligations. However, OCFO will ensure that there are strong internal controls over obligations and deobligations in order to prevent material misstatements.

Systems Development for Grant and Inter-Governmental Applications.

The OIG considers two applications used to process grant payments and track intra-governmental documents as major systems as the data feeds into the Agency's financial management system. As a result, the OIG outlined several documentation and risk assessment requirements that the OCFO has agreed to perform. Several actions have taken place. A risk assessment was completed for the grants payment and tracking applications in August 2004 and October 2004, respectively. OCFO will conduct and document a formal review of the grants payment application's compliance with all applicable and relevant Joint Financial Management Improvement Program requirements. In addition, an

office-wide Standard Operating Procedure will be developed to insure that all future system development efforts, including enhancements, follow relevant agency system development policy.

System Certification and Accreditation for Grant and Inter-Governmental Applications.

Consistent with the OIG observation noted above, OCFO agreed to conduct several assessments on these applications. Formal certifications on both applications were completed by October 2004. The accreditation documents were included with the security plans signed in September 2004. OCFO will develop a Standard Operating Procedure that will formalize the patch management process in November 2004. In addition, procedures will be developed to assure vulnerability scanning and control testing takes place on a regular basis. These efforts will be coordinated with the OIG.

Integrated Financial Management System Change Control Procedures.

In Audit Report No. 2002-P-00026, *EPA Needs to Improve Change Controls for Integrated Financial Management System*, OIG noted a general breakdown of security controls that

could undermine the integrity of the central accounting system's software libraries and financial system data. The OIG provided several recommendations. However, OCFO disagrees that there is a breakdown of security controls affecting the integrity of the Agency's accounting system. OCFO has instituted a formal, structured change control process. This process serves to mitigate risk and provides assurance to the Agency that information is reliable within the Agency's financial management system.

Integrated Financial Management System Automated Application Processing Controls.

The OIG notes that it is unable to assess the adequacy of the automated internal control structure of the Agency's legacy accounting system based on existing documentation. OCFO has plans to update its legacy financial management system and will address documentation issues as part of the replacement anticipated by Fiscal Year 2008. However, in the interim, OCFO maintains that current documentation levels are sufficient for operations. OCFO is in the process of developing an acquisition strategy, governance structure, replacement system project plan, and concept of operations document to support pending financial systems replacement.

II. Federal Financial Management Improvement Act (FFMIA) Noncompliance Issues

The OIG identified no substantial non-compliance issues with FFMIA, however, four other noncompliances are noted below:

EPA Continues to Make Efforts to Improve its Cost Accounting Processes.

The OIG recognizes that OCFO has made improvements in its cost accounting. OCFO remains committed to insuring that financial information is available for decision-making within the Agency. The efforts to date, as acknowledged by the OIG, moves the Agency further along in defining program specific financial information needs and enhancing decision-

making capabilities. During FY 2005, OCFO will continue making progress

Reconciliation of Intragovernmental Transactions.

The OIG referenced government-wide difficulties in reconciling intragovernmental transactions. EPA continues to make strides in reconciling the Agency's intra-governmental transactions and complying with Federal financial reporting requirements. Although this requirement is a major issue government-wide, EPA performs exceptionally well.

Financial System Security Plans. The OIG identified that EPA had taken several actions to correct security issues and implement the FY 1999 Remediation plan, to include issuing a policy on personnel security screening processes. The OIG noted the policy was fully implemented, except for establishing a target date for addressing security certification for non-Federal personnel (e.g., contractors). OCFO has outlined appropriate corrective actions concerning contractors' access to the agency's financial management system and assured that all contractors receive suitable background investigations or investigations are in process. OARM is also committed to mitigating potential security risks. OARM currently has adequate interim procedures in place to guide offices through the security screening process. The Office of Administration and Resources Management (OARM) is also committed to mitigating potential security risks at the Agency level. OARM has interim procedures that guide offices through the security screening process. OARM is also implementing several

improved processes, such as insertion of suitability criteria into contract requirements; fingerprint and national criminal history checks; and commercial checks performed by private firms. Existing internal controls, combined with planned improved processes, ensure that EPA's security screening process is solid and meets future goals.

EPA Continues to Improve Its Compliance with Reconciling Its Funds Balance with Treasury. The OIG noted that EPA has made significant progress in reconciling its cash balances with Treasury. However, two offices continued to include amounts on the Statement of Transactions that did not come from the Agency's accounting system. OCFO provided training in September 2004 and each finance office instituted the appropriate reconciliation procedures. EPA took action to implement Treasury procedures consistent with Agency policy during the fiscal year. OCFO will continue to monitor cash reconciliations to ensure they are properly completed.

Improving Financial Management

Goals and Strategies for Improved Financial Performance. EPA's strategy in support of the President's Management Agenda is to provide accurate data in a timely manner by using technology to maximize data collection and reporting capabilities. EPA's financial management activities include improving financial reporting by integrating performance and financial data; improving the

Agency's ability to reduce or eliminate Improper Payments; deploying E-Travel Agency-wide; replacing legacy systems to meet Federal reporting requirements; and improving overall financial management performance. EPA expects to obtain clean audit opinions, reduce improper payments, improve financial reporting, and issue the PAR 45 days after the fiscal year ends.

Financial Management Performance

EPA does not anticipate significant impediments to its financial performance. There may be minor impediments, e.g., requirements for tracking the payment cycle

to satisfy the improper payments criteria. Although EPA cannot state with certainty the difficulty in meeting that requirement, we believe we can resolve issues as they arise.

Approaches to Clean Audit Opinions:

Clean opinions are a top management priority, and the Agency will continue providing resources for financial statement preparation, improving and automating the statement preparation process, and reflecting these priorities in the Agency's Annual Performance Plan and Budget.

Accelerated Year-End and Periodic

Reporting Requirements: EPA aggressively managed the financial statement acceleration effort and has adopted government-wide "best practices." EPA will continue to produce: (a) accelerated audited statements, (b) more timely, accurate, and useful interim statements and (c) timely financial data to

assess program costs and aid the annual budget formulation process.

Improved Financial Reporting: EPA launched the Office of the Chief Financial Officer Reporting and Business Intelligence Tool (ORBIT), which is designed to provide users Agency-wide with improved access to financial, administrative, and operational information. Future development phases will enhance ORBIT's functionality, focus on programmatic and performance reporting capability, and provide additional data sources.

Financial Management Systems Framework

EPA has undertaken a comprehensive effort to modernize the suite of financial systems that record transactions and perform accounting and budget tasks. Our current core accounting system, the Integrated Financial Management System (IFMS) dates back to 1989. While IFMS performs most functions adequately, it is inefficient by today's standards, and EPA plans to replace it with a modern JFMIP certified system are under way.

Several financial and mixed systems interface with IFMS. Modern reporting and warehousing tools include a Financial Data Warehouse, an Administrative Data Mart, and the Office of the Chief Financial Officer Reporting and Business Integration Tool, a state of the art commercial off the shelf reporting tool. Two EPA financial systems are unique in federal government. In FY 2004, we completed preparations for the October 2004 launch of PeoplePlus, a fully integrated

Human Resource / payroll / time and labor system, and EPA is the only Federal agency with an automated budget formulation system, the Budget Automation System. Additional systems support program financial activities such as Super Fund and administrative activities such as grants, contracts, and travel.

Our modernization effort will take advantage of technology and business opportunities to better integrate systems and add functionality to improve EPA's financial management and budget performance integration. Our efforts are consistent with the e-government initiatives led by OMB that seek to gain efficiencies and improve financial management across government. See <http://www.whitehouse.gov/omb/egov/>.

EPA's Five Year Plan contains a listing of OCFO's systems at <http://www.epa.gov/ocfopage/finstatement/5yearplan2005-2009.pdf>.

Grants Management

EPA's guidance that prescribes the OMB format for use by all offices that award discretionary grants or cooperative agree-

ments is posted on the EPA intranet at the Grants website.

EPA's guidance to implement OMB's requirement for grant applicants to use a D&B DUNS number when applying for EPA grants and cooperative agreements is posted on the EPA intranet on the Grants web site. EPA has also posted on its intranet site the guidance to implement OMB's requirement to post synopses of funding opportunity announcements at Grants.gov using the government-wide standard data elements for these synopses.

EPA is the first agency to bind to the Grants.gov WSDL. EPA anticipates six programs available for application through Grants.gov during FY 2005. Recently, EPA posted electronic applications for the Science to Achieve Results program and received 16 electronic applications. Other programs will be posted later this year.

COSTS RELATING TO GRANTS MANAGEMENT

There are approximately 155 employees, whose salaries range from GS-5 to GS-15 (\$24,075 - \$113,674) in four job categories: grants management specialist, grants management officer, grants policy specialist, and information technology specialist with responsibilities related to grant databases and web applications. In addition, there are over 1700 project officers who have grants management responsibilities. Additional grants management information is in the Five Year Plan at <http://www.epa.gov/ocfopage/finstatement/5yearplan2005-2009.pdf>.